Case No. 83-43

In the Supreme Court of the United States

October Term, 1982

THE CLEVELAND ELECTRIC ILLUMINATING COMPANY,

Appellant,

vs.

THE PUBLIC UTILITIES COMMISSION OF OHIO,

and

OFFICE OF CONSUMERS' COUNSEL,

Appellees.

ON APPEAL FROM THE SUPREME COURT OF OHIO

REPLY BRIEF AND SUPPLEMENTAL APPENDIX OF APPELLANT OPPOSING THE MOTION TO DISMISS OR AFFIRM

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INTRODUCTORY STATEMENT

Appellee, Office of Consumers' Counsel (OCC), has filed a Motion To Dismiss Or Affirm (OCC Motion). This Court should overrule that Motion and allow plenary consideration.

OCC should not be permitted to divert attention from the unprecedented decision below. In its simultaneous decisions of April 13, 1983,[1] the Ohio Supreme Court announced that *this* Court has deferred "completely" to the "legislative will," has adopted the "theory of legislative hegemony," and, by declining to hear utility appeals, has recognized that "the Constitution no longer provides any special protection for the utility investor." (CEI Appx., pp. 18-20). Against this extraordinary statement of the "federal constitutional backdrop" (CEI Appx., p. 20), the Ohio Supreme Court then held in this case that:

> "The Public Utilities Commission's disallowance of a utility's request to treat its expenditures associated with a cancelled generating plant as amortizable costs pursuant to R.C. 4909.15(A)(4) *does not violate* the Fifth and Fourteenth Amendments of the Constitution of the United States." (CEI Appx., p. 37, emphasis added).

OCC makes the argument that this decision should not receive plenary consideration because:

> "The exclusion of one cost from allowable operating expense does not automatically render rates resulting from the application of the Ohio ratemaking scheme in conflict with the constitutional standards enunciated by this Court." (OCC Motion, p. 31).

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[1] *Dayton Power & Light Co. v. Pub. Util. Comm.*, 4 Ohio St.3d 91, 447 N.E.2d 733 (1983), CEI Appx. pp. 5-32, and *Cleveland Electric Illuminating Company v. Pub. Util. Comm.*, 4 Ohio St.3d 107, 447 N.E.2d 746 (1983), CEI Appx. pp. 33-38. For these decisions and the others reproduced in the Appendix, we will cite to the Appendix page for convenience.

While we can agree with this statement, it does not frame the issue here. The true question is whether the State of Ohio can define "costs" (expenses allowable for utility ratemaking purposes) *to exclude a cost which the State of Ohio has required the utility to incur.*[2] Can the State constitutionally impose a cost but deny its recovery?

The answer should be obvious. Yet the Ohio Court held that "Notwithstanding the provisions that impose a duty on utility companies to plan for the future . . ." (*See* CEI Appx., pp. 21 and 289), the State of Ohio could *take* $56.4 million from appellant's investors, without being subject to review by this Court, because "the Constitution imposes no methodological strictures on ratemaking authorities." (CEI Appx., p. 36). It is, of course, unnecessary to uphold any particular "methodological strictures" in order to conclude that the Constitution prevents the State from simultanously requiring a utility to make expenditures and prohibiting any recovery of such expenditures from the rate-payers for whose benefit they were mandatorily incurred. CEI believes that plenary consideration of the extraordinary decision below is necessary.

ARGUMENT

I. THE DOCTRINES OF *RES JUDICATA* AND COLLATERAL ESTOPPEL ARE INAPPLICABLE TO THIS CASE.

OCC argues (pp. 11-20) that this Court's prior dismissals of other rate cases (Case Numbers 81-1002 and 82-704) "for want of a properly *presented* federal question" (emphasis added) were dismissals on the merits and therefore that this appeal is barred by *res judicata*.

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[2]It is undisputed that a part of an Ohio utility's obligation to furnish "adequate *service* and facilities" under Ohio Revised Code Section 4905.22 is the duty to "*anticipate load growth years in advance to maintain adequate capacity to ensure reliable service. . . .*" (CEI Appx., p. 283, emphasis added).

This is simply not so. *See* R. STERN AND E. GRESSMAN, SUPREME COURT PRACTICE, 380-381 (5th ed. 1978); *Colorado Springs Amusements, Ltd. v. Rizzo*, 428 U.S. 913, 914 n.1 (1976, Justice Brennan dissenting); *Doe v. Delaware*, 450 U.S. 382, 383 n.4 (1981, Justice Brennan dissenting). The prior dismissals for want of proper presentation show that the federal queston was *not* addressed and decided by the Ohio Court in the prior two cases.

Nothing in *Hicks v. Miranda*, 422 U.S. 322 (1975), holds to the contrary. In *Hicks*, this Court was addressing the effect of a dismissal "for want of a *substantial* federal question" (422 U.S. at 342-344, emphasis in the original) where a federal constitutional issue "was properly presented." (422 U.S. 344). *Hicks* is obviously inapplicable to this Court's prior dismissals "for want of a properly *presented* federal question." Thus, the Ohio Supreme Court itself did not rely, and could not properly have relied, on *res judicata* or collateral estoppel in rendering its judgment in this case. OCC's attempt to inject these concepts into the case at this stage (it did not do so below) is baseless.

OCC next argues (OCC Motion, pp. 20-22) that, because CEI's first proposition of law to the Ohio Court in this case requested reexamination of the "new law" announced in *Consumers' Counsel v. Pub. Util. Comm. (CEI)*, 67 Ohio St.2d 153, 423 N.E.2d 820 (1981), CEI Appx., pp. 276-300 (hereinafter cited as *Consumers' Counsel*), this Court is precluded from deciding the constitutional issue drawn in question by appellant's second proposition of law. The argument has no merit. CEI asked the Ohio Court to reexamine that same state law issue (*See* CEI Appx., p. 34) because, if it had done so, the federal question might have been avoided. The Ohio Court, however, "adhered" to its construction of Ohio Revised Code Section 4909.15(A)(4) announced in *Consumers' Counsel* (*See* CEI Appx., p. 35) and there-

fore reached and decided appellant's second proposition of law which was that the statutes, as construed and applied, breach the federal constitution. (CEI Appx., pp. 35-37).

OCC's reliance (pp. 22-26) on *Grubb v. Pub. Util. Comm.*, 281 U.S. 470 (1930), is misplaced. *Grubb* involved a federal district court suit which collaterally attacked a Public Utilities Commission order by asserting grounds that were available to, but not asserted by, Grubb before the Commission or, as appellant, before the Ohio Supreme Court. Unlike Grubb, CEI was not the appellant, but an intervening *appellee* before the Ohio Court in *Consumers' Counsel*. There was no occasion for CEI, as appellee, to assert the unconstitutionality of the relevant statutes, since the unconstitutionality did not exist until after the Ohio Court's announcement in *Consumers' Counsel* of what the Ohio Court itself has acknowledged was "new law." (*See Consumers' Counsel v. Pub. Util. Comm. (Toledo Edison)*, 1 Ohio St.3d 22, at 24, 437 N.E.2d 586, at 588 (1982).) At every available opportunity since the "new law" was announced, appellant CEI has drawn in question the constitutionality of that "new law." *See* United States Supreme Court Cases A-250 (filed September 22, 1981), 81-1002 and 82-704.

Furthermore, this appeal is not a collateral attack on the rate order in *Consumers' Counsel*, but rather an appeal from appellant's first rate case decided after the announcement of that "new law", with a new test year, new rate base, new revenues, new expenses, and new required rate of return. *See Commissioner v. Sunnen*, 333 U.S. 591 (1948). In its decision below (CEI Appx., pp. 168-257), the Ohio Commission, for the first time in the context of a complete rate case, denied all recovery as an allowed operating expense of appellant's expenditure of $56,400,000 for planning and engineering these now-cancelled generating plants. (CEI Appx., pp. 220-221).

OCC misses the import of the Ohio Court's decision when it argues (pp. 24-29) 1) that the Ohio Court strictly limited its determination in *Consumers' Counsel* to construing Ohio Statutes, 2) that *Consumers' Counsel* represents an adequate state ground for the decision in *this* case, and 3) that such an "adequate state ground precludes review by this Court." The Ohio Court did not rely on any "state ground" in deciding the federal issue. *Compare Hathorn v. Lovorn*, 457 U.S. 255 (1982). Instead, the Ohio Court explicitly addressed and rejected appellant's second proposition of law in this case and held that Ohio Revised Code Section 4909.15(A)(4), as applied to appellant CEI in the rate case here appealed, "*does not violate* the Fifth and Fourteenth Amendments of the Constitution of the United States." (CEI Appx., pp. 35 and 37, emphasis added.) Whatever may be said of the procedural posture of CEI's earlier appeals insofar as the federal question was concerned, *see Republic Natural Gas Co. v. Oklahoma*, 334 U.S. 62, 71 (1948), in this case the merits of the federal question were tendered and resolved in the state court proceedings and are now properly before this Court.

II. AS APPLIED BELOW, OHIO REVISED CODE SECTIONS 4905.22 AND 4909.15(A)(4) CONFISCATE APPELLANT'S PROPERTY WITHOUT DUE PROCESS OF LAW.

The federal question decided below is plainly a substantial one requiring a decision by this Court. The decision below squarely conflicts with the decisions of this Court and a recent decision of the Wisconsin Supreme Court. *West Ohio Gas Co. v. Pub. Util. Comm.*, 294 U.S. 63, 68 (1935); *Wisconsin Public Service Corp. v. Pub. Serv. Comm.*, 109 Wis.2d 256, 325 N.W.2d 867 (1982).

OCC addresses the merits of the substantial federal question presented here by arguing that appellant CEI

seeks "to totally insulate investors from any risk." (OCC Motion, p. 49). That is not correct. In this proceeding CEI sought recovery *of* the $56.4 million prudently spent planning and engineering these units as required by Ohio Revised Code Section 4905.22. *See West Ohio Gas Co. v. Pub. Util. Comm.*, 294 U.S. 63, 68 (1935); *Public Service Commission for the State of New York v. Fed. Power Comm.*, 467 F.2d 361, 370 (D.C. Cir., 1972); *Transcontinental Gas Pipeline Corp. v. Fed. Power Comm.*, 518 F.2d 459, 464-465 (D.C. Cir., 1975). CEI did *not* seek and has never sought "profit" *on* that $56.4 million investment.[3] In the words of *Bluefield*, CEI has never sought "to earn a return *on* the value of the property . . . ." (262 U.S. at 290, emphasis added). If amortization had been allowed here, CEI's investors would still bear the risk of loss of the anticipated profits and would actually lose the time value of their money. In this case the Ohio Commission denied any recovery at all, just as the Wisconsin Commission had done in the decision reversed by the Wisconsin Supreme Court. *Wisconsin Public Service Corp. v. Pub. Service Comm., supra.*[4] Here, the Ohio Court reached the

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[3]*Compare Gulf Power Co. v. Cresse*, 410 So.2d 492 (Florida Supreme Court, 1982) (wherein the Court affirmed recovery *of* the expenditure through an amortization period *and* a return on the unrecovered balance through rate base treatment of that unamortized balance) *and Webb's Fabulous Pharmacies v. Beckwith*, 449 U.S. 155 (1980) (wherein the Court recognized that a taking of the time value of money may be unconstitutional) *with NEPCO Municipal Rate Committee v. Fed. Energy Reg. Comm.*, 668 F.2d 1327 (D.C. Cir., 1981), *cert. den.* 102 S.Ct. 2928 (1982) (wherein the Court affirmed a FERC order allowing recovery *of* cancelled plant expenditures but denying a return *on* the unamortized balance).

[4]*See also Pennsylvania Public Utility Commission v. Duquesne Light Company*, 52 PUR 4th 644, at 650 (1983), where, in a case involving the very same cancelled plants that are the subject of this appeal, the Pennsylvania Commission said that a denial of recovery would raise a "real" constitutional issue.

opposite conclusion and affirmed in the face of an explicit constitutional challenge. The Ohio statutes, in both requiring these expenditures and precluding their recovery as a cost of service, confiscate the investors' property. The constitutionality of a statutory scheme which requires an expenditure and prohibits its recovery is what this case is about.

OCC is mistaken when it argues (pp. 41-46) that there is no federal question because there is no showing that the total effect of the rate order is unjust and unreasonable, citing *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, at 602 (1944).[5] *Hope* holds that "It is not theory but *the impact of the rate order* which counts." (320 U.S. at 602, emphasis added). As things stand, the "impact of the rate order" appealed here, unless reversed, will be the immediate write-off of $56.4 million. (*See* CEI Appx., pp. 419-421). The Federal Energy Regulatory Commission, through its Acting Chief Accountant, has agreed not to require that immediate write-off while legal efforts are still pending. (*See* August 4, 1983 letter, attached hereto in CEI's Supplemental Appendix).

If that write-off had been required in 1982 (the most recent calendar year for which figures are available), appellant's reported return on equity of 15.3% would have been reduced to 12.6%. Contrast this with the Commission's finding in March, 1982 in this case that appellant was entitled to a return of 17.30%. (CEI Appx., p. 244). If that write-off had been required in 1982, appellant's reported earnings per share of $3.01 would have been reduced by $.51, or nearly 17 percent. In short, the reasonableness of the rate order in this case cannot be judged

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[5]OCC's reliance on *Hope* is at best anomalous, since the Ohio Court itself indicated that *Permian Basin Area Rates Cases*, 390 U.S. 747 (1968) emasculated *Hope*. (CEI Appx., p. 19). Thus, OCC is in the uncomfortable position of seeking to defend the Ohio Court's decision with an authority that the Ohio Court repudiated.

merely by the impact of the denial of the annual amortization amount in the test year, but must be judged by the resulting impact of the loss of the entire planning expenditure ($56.4 million) which may occur as a consequence of the decision in this case. Fifty-six million dollars *is* property and it *is* confiscated by the rate order appealed here.

OCC's argument that no federal question arises because the Commission allowed an increase in the rate of return on common equity for the additional risk resulting from the *Consumers' Counsel* decision mistakes the issue. It is directly refuted by the position of the FERC staff that the additional rate of return is to compensate appellant's present investors for now taking the risk that some other prudent investments in utility property may be confiscated in the future. If FERC accepted OCC's argument, it would not be directing Appellant to write-off this investment. (*See* FERC letter reproduced at CEI Appx., pp. 419-421). Here we are dealing with an expense actually incurred; it is either in or out. The $56.4 million is either an asset or it is not. These are the alternatives.

OCC's argument (pp. 46-51) that no confiscation has occurred because CEI's 1979 Annual Report predicted that "the resolution of these matters should not have a material adverse impact on the financial position of the Company" is also erroneous. That statement addressed the SEC's *balance sheet* test, not the impact on earnings, and certainly not this Court's test for unconstitutional confiscation. This Court has never held that a taking must be so great in size that a corporation's financial integrity is seriously impaired in a securities law sense before an unconstitutional confiscation can be said to have occurred. *See Kaiser Aetna v. United States*, 444 U.S. 164 (1979); *Loretto v. Teleprompter Manhattan CATV Corp.*, ___ U.S. ___, 73 L.Ed.2d 868, 876, 102 S.Ct. 3164, 3171 (1982). When CEI's investors provided this money for the convenience of the public, as required by statute, they had the reasonable expectation that the integrity of their invest-

ment would be maintained and that they would at least get their money back. *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 606 (1944); *Public Service Commission for the State of New York v. Fed. Power Comm.*, 467 F.2d 361, 370 (D.C. Cir., 1972). Unless this Court reverses, the State of Ohio will have *taken* $56.4 million from CEI's investors.

CONCLUSION

This case presents this Court with a clear-cut issue: Is it constitutional for Ohio, on the one hand, to require appellant's investors to provide money to ensure reliable service in the future and then, on the other, deny any opportunity whatsoever to recover that money? The Ohio statutes, as construed and applied here, impose that result and plainly have confiscated appellant's property. For the foregoing reasons, the question presented is so substantial as to require plenary consideration, with briefs on the merits and oral argument, for its resolution, and the Motion To Dismiss Or Affirm should be denied.

Respectfully submitted,

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SUPPLEMENTAL APPENDIX

FEDERAL ENERGY REGULATORY COMMISSION
WASHINGTON, D.C. 20426

IN REPLY REFER TO:
OCA-AS

August 4, 1983

Mr. Charles C. Chopp
Controller
The Cleveland Electric
Illuminating Company
Post Office Box 5000
Cleveland, Ohio 44101

Dear Mr. Chopp:

We have reviewed your letter dated June 15, 1983, in which you submitted supplemental information regarding your Company's continuing legal efforts to recover the loss from the termination of proposed units at the Davis-Besse Nuclear Station and Erie Nuclear Plant, and requested another extension of time for writing off such loss.

Based upon the information disclosed in your letter, we will continue to hold in abeyance until no later than December 31, 1983, the accounting directed in our letter of July 7, 1982. If your legal efforts do not prove successful in the interim, the loss shall be written off at the time these efforts are ended.

Sincerely yours,

/s/ Russell E. Faudree, Jr.
Acting Chief Accountant